87-497

No.

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1987

JEROME I. FELDMAN, *et al.*,

Petitioners,

vs.

PIONEER PETROLEUM, INC., *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

In a case arising under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), involving a tax shelter program which the Internal Revenue Service subsequently finds to be a "sham":

1. Are plaintiffs, innocent investors in the program, as a matter of right, entitled to elect rescission as a remedy?

2. Are such plaintiffs barred from electing rescission when any delay in filing a suit did not benefit the plaintiffs or harm the defendants?

3. When a trial court finds that an investment was a "sham," does evidence of out-of-pocket damages require further expert testimony?

LIST OF PARTIES

Petitioners in the proceedings below were 72 individuals (or their successors) who purchased interests in oil and gas partnerships denominated the Bradford 1972 Partnerships, marketed as a tax shelter, of whom four, Jerome I. Feldman, Barry M. Brookstein, Albert E. Abraham and Albert A. Rettig, were selected by all parties as representative of the various groups of investors. Each of these individuals is a petitioner before this Court.*

Respondents are The Estate of William D. Bradford, promoter of the Bradford 1972 Partnerships; Pioneer Petroleum, Inc., and an affiliated corporation, Frontier Corporation; Fidelity Bank, N.A., a bank which purported to make Carved-Out Production Payment (COPP) loans to the Bradford partnerships; and Alice June Harris, the Executor of the Estate of Fidelity's former President, Grady Harris, who executed the sham COPP loan documents. Each of these parties is a respondent before this Court.

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* The additional petitioners are: Martin M. Poilak, Leonard Rovins, Morris J. Fellner, Leo P. Arnaboldi, Jr., Joel T. Comiteau, Estate of Leo L. White, Leumas Knitting Mills, Inc., J. & S. Industries, Jeff Mishcon, Sherman Michaelson, Arnold Y. Arnoff, Paul Todtfield, Sidney Martin, Charles Maris, Peter Maris, Charles Bloomgarden, Gerald Blumenthal, Samuel Messing, Solomon Liebowitz, Barry Garsson, Oscar Goldberg, Robert Zaretzky, Joseph Longo, Joseph Slavin, Joseph Arandia, E. Marvin Sokol, Anthony Micalo, Richard Adelson, Carl Klein, Joseph Pressler, Frederick Rudman, Gustav Gomprecht, Harold F. Rudman, Elva Thompson, Neil Wassner, Ray Chessman, Michael Stern, Stanley Dershowitz, Henry Pollack, Herman E. Goodman, John Maher, Lee Mehlig, Estate of Sherman Michaelson, Richard Kahn, Patricia Donovan, Sheldon Krieger, Louis Meany, John LaGrua, Daniel Matarrasso, John Telling, Jay Harbeck, Tenison Newsom, Werner Ostburg, Lewis Crowley, James Morrill, Eileen Ford, Estelle Kessler, Herman Rosenberg, O. J. Glantz, Erich Segal, Hal Linden, Michael Stewart, Joseph Cates, Jerry Katz, Saul Lazarow, Aretha Franklin, Jerry Vale, Herbert Weinreb, Roone Arledge, Alex Stoopler, Allan Abrams, Julian Stoopler, and Frederick Schwartzman.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The petitioners, Jerome I. Feldman, *et al.*, respectfully pray that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit, entered in the above entitled proceeding on March 5, 1987, and the denial of petitioners' request for rehearing en banc, entered on July 7, 1987.

OPINIONS BELOW

The opinion of the United States District Court for the

Western District of Oklahoma, reported at 606 F. Supp. 916, is reprinted as Appendix A annexed hereto, pages 1a-25a.[1]

The opinion of the Court of Appeals for the Tenth Circuit, reported at 813 F.2d 296, is reprinted as Appendix B annexed hereto, pages 26a-38a.

The opinion of the Court of Appeals for the Tenth Circuit denying petitioners' request for rehearing en banc, not officially reported, is printed as Appendix C annexed hereto, pages 39a-41a.

STATEMENT OF JURISDICTION

Invoking federal jurisdiction under 28 U.S.C. § 1331 petitioners commenced this action in 1976 in the United States District Court for the Southern District of New York. Following this Court's decision in *Radzanower v. Touche Ross,* 426 U.S. 148 (1976), and because one of the principal defendants was a national bank, the action was transferred by agreement to the Western District of Oklahoma. The District Court for the Western District of Oklahoma dismissed petitioners' complaint at the close of their presentation of evidence, pursuant to Rule 41(b), Federal Rules of Civil Procedure, on February 28, 1985. (*See* Appendix A, p. 1a, *infra.*)

On petitioners' appeal, the Court of Appeals for the Tenth Circuit entered a judgment affirming the dismissal. (*See* Appendix B, p. 26a, *infra.*)

A timely petition was made to the Tenth Circuit for rehearing en banc and denied on July 7, 1987. (*See,* Appendix C, p. 39a, *infra.*)

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1. Pages of the Appendix are cited as "___a."

The jurisdiction of the Court to review the judgment of the Tenth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b);

Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5;

Securities Exchange Act § 28(a), 15 U.S.C. § 78bb(a);

Securities Exchange Act § 29(b), 15 U.S.C. § 78cc(b).

The statutes and regulations involved are set forth in their entirety in Appendix D annexed hereto, pages 42a-46a.

STATEMENT OF THE CASE

This is a private action for rescission (and rescissionary damages) or in the alternative legal damages based on violations of § 10(b) of the Securities and Exchange Act, 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5, and common law fraud. Initially, the District Court determined that the case could be maintained as a class action. The class, however, was subsequently decertified, and a suit was brought on behalf of 72 individuals who invested $4.3 million in limited partnership interests in a 1972 oil recovery program, denominated the Bradford 1972 Partnerships. At the agreement of all parties, four individual petitioners were selected as representatives of all investors for a trial of their case in its entirety. Only if these four petitioners succeeded in proving liability and damages would evidence be presented for the other petitioners, and the evidence would be limited to reliance and damages (Appendix A, p. 1a, *infra*).

The investment program consisted of several two-tiered

partnerships structured so that the investor purportedly would be able to take a tax deduction equal to 180 percent of the cash invested (Appendix A, p. 3a, *infra*). This deduction was based upon a representation in the prospectus that upon investment in a first tier partnership, the promoters would obtain a non-recourse carved out production payment ("COPP") loan from a bank in an amount equal to the initial investment in the first tier partnership. This COPP loan would fund an investment in a second partnership. Hence, a person who invested $10,000 in Partnership A would obtain a $10,000 COPP loan to invest in Partnership B and would be entitled to deduct 90 percent of each investment, thereby receiving his or her 180 percent deduction. During the initial years of the partnership, the investors also received a small cash return (Appendix A, p. 16a, n. 6, *infra*).

After a total of $800,000 had been invested in the first partnership, investors and potential new investors were informed that an $800,000 COPP loan "has been arranged" (Pl. Exh. 13, T771),[2-3] and, on September 25, 1972, the president of Fidelity Bank, N.A. ("Fidelity") executed a COPP loan document evidencing such a loan when, in fact, no monies had been advanced (Pl. Exh. 14). The document was disseminated to investors to induce additional cash investments in the program, which additional investments exceeded $3,000,000. Similar sham documents were executed in December (Pl. Exh. 73, 74).

In 1975, the Internal Revenue Service (the "IRS") commenced a review of the 1972 Bradford Partnerships, found that no valid COPP loan had been made and that the entire tax shelter program was a sham. All tax deductions taken by petitioners with respect to the second-tier partnerships, as well as a substantial portion

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2, 3. References proceeded by "T" are to the trial transcript. References preceded by the "Pl. Exh." are to exhibits which were introduced into evidence during the trial.

of the first-tier deductions, were disallowed. The petitioners disputed the IRS's disallowances and the resultant Tax Court litigation was unresolved at the time of trial (Appendix A, p. 5a, *infra*).

Petitioners filed suit in March 1976. They alleged that the prospectuses used to sell the limited partnership interests contained materially false and misleading statements concerning the COPP loans. They further claimed that Bradford, aided and abetted by Fidelity, engaged in an elaborate scheme to induce investors to believe that the COPP loans had been made to the partnerships when in fact no valid loans had been made (Appendix A, pp. 2a-6a, *infra*).

After a bench trial in May 1983, the District Court on February 28, 1985 issued an opinion. The court concluded that Bradford and an affiliated corporation, Pioneer Petroleum, Inc., had violated § 10(b) and Rule 10b-5 by making false and misleading statements and by engaging in a scheme to cover up the sham COPP loans. The court found Fidelity liable as an aider and abettor for having rendered substantial assistance to the scheme creating the appearance of a valid COPP loan by creating fraudulent COPP loan documents signed by Fidelity's president which were disseminated to investors (Appendix A, pp. 19a-20a, *infra*).

Nevertheless, the District Court dismissed the action on the ground that the petitioners had shown no damages (Appendix A, p. 25a, *infra*). There are three bases offered for this conclusion.

First, the District Court held that petitioners had forfeited their right to the remedy of rescission by delaying until March 1976 the filing of this action. The court found that petitioners had received a letter in June 1974 from the promoter's accounting firm, Hurdman & Cranstoun, that was "sufficiently suggestive

of the alleged fraud," and "the Court finds the Plaintiffs did not act with all reasonable dispatch as nearly two years elapsed prior to their seeking this relief." (Appendix A, p. 14a, *infra*).

Second, in calculating rescissionary damages, the District Court expressly followed the rule established by *Austin v. Loftsgaarden,* 675 F.2d 168, 181 (8th Cir. 1982), *aff'd en banc,* 768 F.2d 949 (8th Cir. 1985), *rev'd sub nom., Randall v. Loftsgaarden,* 478 U.S. ____, 106 S. Ct. 3143 (1986), and offset petitioners' claim for damages by the amount of tax deductions. The court was aware that ongoing IRS litigation concerning the deductions might result in damages to petitioners even under its application of a tax offset rule, but concluded that "such damages are purely speculative at this point." When the initial 180 percent deduction was taken into account, the court concluded that petitioners had failed to prove actual losses (Appendix A, p. 16a, *infra*).

The Court of Appeals found a third basis for the District Court's conclusion in a single sentence in a footnote in the District Court's opinion: "Additionally, as early as December 31, 1980, this Court indicated its willingness to consider damages based on the value difference between the investment purchased and the price paid, however, no expert testimony was introduced positing such valuations." (Appendix A, p. 15a, fn. 5, *infra*).

Because of the pivotal role this sentence played in the Tenth Circuit review of the District Court decision, it is worth underlining precisely what it meant. At trial, there were introduced into evidence IRS reports which were the basis for the District Court finding "in 1975, the IRS audited the investors' deductions and found that a valid COPP loan had not been acquired and that the tax shelter was a sham." (Appendix A, p. 15a, *infra*). Investors testified that their investment was not "saleable," (T637, 642). An expert witness, Bruce Peterson, an attorney and professor

specializing in oil and gas matters, testified that without the promised tax benefits, the 1972 Bradford Program "would not be marketable" (T1049). This testimony was uncontroverted. The District Court itself concluded, "It is uncontroverted that the partnerships have ceased to produce any income and are not saleable at this time." (Appendix A, p. 16a, n. 6, *infra*). Thus, what the District Court apparently meant was that the petitioners had failed to call an expert witness specifically to testify concerning "damages based on the value difference between the investment purchased and the price paid" at the time of the investment.

On the appeal from the District Court decision, the Securities and Exchange Commission (the "SEC") filed a brief as *amicus curiae* in support of petitioners, addressing the question whether respondents' liability for losses caused by securities fraud could be reduced or eliminated because the petitioners had received tax benefits.

Before the Court of Appeals for the Tenth Circuit issued its opinion, this Court reversed *Austin v. Loftsgaarden, supra,* the principal basis of the District Court's conclusion on damages, and held in *Randall v. Loftsgaarden, supra,* 478 U.S. ____, 106 S. Ct. 3143 that the recovery available to a defrauded tax shelter investor entitled under § 12(2) of the Securities Act of 1933 or § 10(b) of the Securities Exchange Act of 1934 to rescission or rescissionary damages could not be reduced by any tax benefits the investor received from the tax shelter investment.

The Court of Appeals, nonetheless, affirmed the District Court decision (Appendix B, p. 26a-38a, *infra*). The Court of Appeals was not "persuaded that the District Court improperly refused to consider the plaintiffs' alternative remedy of rescission upon a finding that plaintiff waited nearly two years to assert this equitable relief after they had 'information sufficiently suggestive of the alleged fraud' by the defendants." (Appendix B, p. 36a, fn. 10, *infra*).

With respect to calculation of rescissionary damages, the Court of Appeals agreed "with the District Court that the record discloses that the plaintiffs offered no competent evidence throughout the eight-day bench trial of their case in its entirety to satisfy the burden of proving their claims for damages." (Appendix B, p. 31a, *infra*).

A subsequent timely petition to the Tenth Circuit for a rehearing en banc was denied without an opinion (Appendix C, p. 39a, *infra*).

REASONS FOR GRANTING THE WRIT

The enormous financial impact on investors of tax shelter fraud and the need and availability of feasible and appropriate civil remedies has led the SEC to file *amicus* briefs in a number of civil actions, including this case in the court below. The need for adequate remedies has not been eliminated by the Tax Reform Act of 1986, first because of the many claims pending and those still incipient or unknown that arose prior thereto, and second, because even after the 1986 amendments there exists the potential for substantial additional abuse which would be deterred by strong civil remedies available to victims of tax shelter frauds.

While this action like the earlier *Randall v. Loftsgaarden, supra*, 478 U.S. ____, 106 S. Ct. 3143, involves a tax shelter investment program, the legal issues involved have a broader significance. Commentators have consistently recognized that the law regarding the remedies which can be obtained by a plaintiff who established a cause of action under § 10(b) and Rule 10b-5 is currently in both a "formative" and "confused" state. *See, e.g.*, R. Jennings & H. Marsh, *Securities Regulation* 1384, 1390 (6th ed. 1987); L. Loss, *Fundamentals of Securities Regulation* 1132 (1983) *quoting* Note, *Measurement of Damages in Private Actions Under Rule 10b-5,* Wash. U. L. Q. 165, 179 (1968) ("there

has been so much variegation in the cases that it is tempting to conclude that 'there is no law of damages under Rule 10b-5'. . .''); Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349, 350 (1984) (''The law relating to private remedies available under Rule 10b-5 is confused. Commentators list up to a dozen separate measures of recovery that prospective plaintiffs may pursue if defrauded in connection with the purchase or sale of a security'').

In *Loftsgaarden, supra*, this Court framed, but declined to resolve, two questions raised in this petition on which the Circuits today are divided: (1) May defrauded investors, as a matter of right, demand rescission or a rescissionary measure of damages in an action arising under § 10(b) and Rule 10b-5? *Randall v. Loftsgaarden, supra*, 478 U.S. ____, ____, 106 S. Ct. 3143, 3152-53; *see infra* at 10-17; *see also*, Note, *Securities Law*, 100 Harv. L. Rev. 295-96 (1986); and (2) Under what circumstances may a court bar a plaintiff from electing rescission or a rescissionary measure of changes because of delayed tender or filing of suit? 478 U.S. at ____, 106 S. Ct. at 3155.

The practical consequence of these conflicts is to create opportunities for the insulation of ''those who commit securities fraud from any appreciable liability to defrauded investors.'' *Randall v. Loftsgaarden, supra*, 478 U.S. ____, ____, 106 S. Ct. 3143, 3154. The resulting diminution in the incentives to comply with the federal securities laws may ''seriously impair the deterrent value of private rights of action,'' which this Court has emphasized ''provide 'a most effective weapon in the enforcement' of the securities laws and are a 'necessary supplement to Commission action.' '' 478 U.S. at ____, 106 S. Ct. at 3154 *quoting Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 310 (1985); *cf. Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983). This is particularly a matter of concern in securities regulation at this time, with the number of securities distributions

at record levels, *see, e.g.*, 52 SEC, Ann. Rep. 139-40 (1986) (in 1986, there were 5,905 securities registration statements, an increase of 992 over the previous year), and the size of the SEC staff essentially static.

I.

Plaintiffs, as a matter of right, are entitled to elect rescission in a case under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b).

Rescission seeks to return the parties in a lawsuit to the *status quo ante* by in effect, cancelling the transaction and returning to the plaintiff the money invested (reduced by any dividends or other income earlier received) and to the defendant the securities sold to the plaintiff. *See Myzel v. Fields*, 386 F.2d 718, 742 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Andrews v. Blue*, 489 F.2d 367, 376 (10th Cir. 1973) ("In a rescission action the proper measure is the amount lost rather than value of the bargain"); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 554 (5th Cir. 1981), *aff'd in part & rev'd in part*, 459 U.S. 375 (1983) ("Rescission is the avoidance or undoing of the transaction. Its purpose is to return the defrauded purchaser to the status quo ante; it contemplates the return of the injured party to the position he occupied before he was wrongfully induced to enter the transaction.").

At the time the Securities Exchange Act of 1934 was adopted, in common law a person induced by a false prospectus to buy stock could sue the seller for rescission as a matter of right. *See, e.g., Seneca Wire & Mfg. Co. v. A.B. Leach & Co.*, 247 N.Y. 1, 159 N.E. 700 (1928); *Hall v. Bank of Baldwin*, 143 Wis. 303, 127 N.W. 969 (1910); 3 J. Pomeroy, *A Treatise on Equity Jurisprudence* § 881 (5th ed. 1941); 3 L. Loss, *Securities Regulation* 1626-27 (2d ed. 1961). As has often been observed,

private remedies under the federal securities laws were designed to supplement, not to diminish, the remedies available at common law. *See, e.g., Bateman Eichler, Hill Richards, Inc. v. Berner, supra*, 472 U.S. at 310.

Nonetheless, what has developed in cases arising under § 10(b) are three cognate approaches to a plaintiff's right to elect rescission, two of which, in essence, may be more restrictive than the remedies available at common law.

We urge that the proper view is that plaintiffs have a general right to elect rescission subject to bar only wnen plaintiffs delay suit in order to increase their recovery or plaintiffs' delay causes avoidable injury to defendants. *See, e.g., Esplin v. Hirschi*, 402 F.2d 94, 104 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969); *Holdsworth v. Strong*, 545 F.2d 687, 697 (10th Cir. 1976), *cert. denied*, 430 U.S. 955 (1977); *Myzel v. Fields, supra*, 386 F.2d at 740-43; *Rogen v. Ilikon Corp.*, 361 F.2d 260, 268-69 (1st Cir. 1966); *Sackett v. Beaman*, 399 F.2d 884, 891 (9th Cir. 1968); *Gordon v. Burr*, 506 F.2d 1080, 1083-84 (2d Cir. 1974); L. Loss, *Fundamentals of Securities Regulation* 1132-33 (1983); R. Jennings & H. Marsh, *Securities Regulation* 1384-85 (6th ed. 1987); 5C A. Jacobs, *Litigation and Practice Under Rule 10b-5*, § 260.03[c][vi] at 11-62 (2d ed. 1987) (citing cases); Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349, 365-66 (1984) (citing cases).

In certain jurisdictions, this general right to elect rescission has been limited essentially to cases involving privity between plaintiff and defendant. *See, e.g., Huddleston v. Herman & MacLean, supra*, 640 F.2d at 554; *Natkin v. Exchange Nat'l Bank of Chicago*, 342 F.2d 675, 676-77 (7th Cir. 1965); *Washington Public Power Supply System*, 650 F. Supp. 1346, 1355 (W.D. Wash. 1986); Mullaney, *Theories of Measuring Damages in*

Security Cases and the Effects of Damages on Liability, 46 Fordham L. Rev. 277, 285 (1977); Note, *Rule 10b-5 Developments—Damages and Contribution*, 39 Wash. & Lee L. Rev. 997, 1001-02 (1982); Note, *Rule 10b-5 Damage Computation: Application of Financial Theory to Determine Net Economic Loss*, 51 Fordham L. Rev. 838, 839 (1983).

A third view is that there is no right to rescission. It, however, may be granted as a matter of judicial discretion. *See, e.g., Blackie v. Barrack*, 524 F.2d 891, 909 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406, 1413 (9th Cir. 1987). In one instance, a District Court held that rescission would only be available when fixing damages presented unusual difficulties, *Baumel v. Rosen*, 283 F. Supp. 128, 146 (D. Md. 1968), *aff'd in part, rev'd in part*, 412 F.2d 571 (4th Cir. 1969), *cert. denied*, 396 U.S. 1037 (1970); in other instances, courts have only granted rescission when they concluded that it was equitable to do so. *See, e.g., Occidental Life Insurance Co. of N.C. v. Pat Ryan & Assocs., Inc.*, 496 F.2d 1255, 1267-68 (4th Cir.), *cert. denied*, 419 U.S. 1023 (1974) (construing § 29(b)); *see generally* 5C A. Jacobs, *Litigation and Practice Under Rule 10b-5*, § 260.03[c][vi] at 11-68 to 11-70 (2d ed. 1987).

A general rule consistent with the deterrent purposes of § 10(b) would allow plaintiffs a right of rescission subject to bar only when plaintiffs delay suit in order to increase their recovery or when delay causes avoidable injury to defendants. In *Randall v. Loftsgaarden, supra*, 478 U.S. ____, ____, 106 S. Ct. at 3151, this Court inferred "that Congress chose a rescissionary remedy when it enacted § 12(2) in order to deter prospectus fraud and encourage full disclosure as well as to make investors whole." This same deterrent policy is equally applicable to prospectus fraud in a claim arising solely under Section 10(b). *See, e.g.*, Note, *Securities Law*, 100 Harv. L. Rev. 295, 303 (1986).

This Court both in *Loftsgaarden, supra*, 478 U.S. at ____, 106 S. Ct. at 3153; and in the earlier, *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 155 (1972) has emphasized deterrence and the prevention of unjust enrichment as the primary policy considerations governing the measure of damages permissible under Section 10(b):

> . . .'[w]here the defendant received more than the seller's actual loss . . . damages are the amount of the defendant's profit.' *Ibid.* This alternative standard aims at preventing the unjust enrichment of a fraudulent buyer, and it clearly does more than simply make the plaintiff whole for the economic loss proximately caused by the buyer's fraud. Indeed, the accepted rationale underlying this alternative is simply that '[i]t is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.' *Janigan v. Taylor*, 344 F.2d 781, 786 (CA1), *cert. denied*, 382 U.S. 879, 86 S. Ct. 163, 15 L. Ed. 2d 120 (1965).

478 U.S. at ____, 106 S. Ct. at 3153. *See also,* L. Loss, *Fundamentals of Securities Regulation* 1134 (1983) (citing cases); Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349 366 (1984).

In some instances, these policies will best be achieved by rescission or rescissionary damages. Unlike out-of-pocket losses or the "actual damages" required by § 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a), "[i]n rescission there is no problem of computing damages." 3 L. Loss, *Securities Regulation* 1628 (2d ed. 1961); *Holdsworth v. Strong, supra*, 545 F.2d at 697. Little more is involved than a straight-forward swap of the

property received by a plaintiff for the consideration received by the defendant (minus earlier distributions) or a calculation of the effect of such a swap. In contrast, other damage theories often will involve estimation of value had securities purchasers been fully informed of a fraud. If value is to be calculated at a time before the fraud is fully disclosed to the market, or if there is no organized market, calculation of actual damages may involve the same type of valuation techniques currently employed in corporate law "appraisal" proceedings. *See, e.g.*, Note, *Rule 10b-5 Damage Computation: Application of Financial Theory to Determine Net Economic Loss*, 51 Fordham L. Rev. 838, 850-58 (1983); regarding appraisal valuation techniques, *see, e.g.*, H. Henn & J. Alexander, *Law of Corporations* 997-1010 (1983).

Within the specific context of the tax offset rule, this Court in *Loftsgaarden, supra*, 478 U.S. at ____, 106 S. Ct. at 3154, acknowledged that the Court of Appeals' "elaborate" method for calculating damages "supplies an additional reason for rejecting its tax benefit offset rule."

> We need not inquire whether evidence concerning tax benefits is ordinarily so speculative as to be beyond the jury's province. . . . It is enough that there are formidable difficulties in predicting the ultimate treatment of the investor's claimed tax benefits, whether or not an audit has commenced, and that the burdens associated with reconstruction of the investor's tax history for purposes of calculating interest are substantial. We think that § 28(a) cannot fairly be read to require such a full-scale inquiry into a defrauded investor's dealings with the tax collector lest the investor escape with anything more than his "net economic loss."

Id. at 3154 (citations omitted). When securities fraud is discovered

long after an initial sale, these same difficulties of estimation may occur in § 10(b) damages calculations. Both the expense of presenting evidence to reconstruct the value of a security at an earlier time and the uncertainty of result may tend to frustrate the deterrent purposes of § 10(b).

Moreover, § 29(b) of the Securities Exchange Act, 15 U.S.C. § 78cc(b), creates a statutory right to rescind contracts made in violation of any provision of the Securities Exchange Act or any rule or regulation thereunder. That section provides, in pertinent part, "Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder . . . shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made . . . any such contract . . . ." (*see* Appendix D, p. 45a). In a case arising under § 14(a) of the Securities Exchange Act, 15 U.S.C. § 78n(a), § 29(b) was recognized as granting to the victim of a fraudulent securities contract "the right to rescind." *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 388 (1970). *Mills* expressly limited this right to cases in which plaintiffs are innocent parties to a fraudulent contract. Thus, the Court denied the statutory right of rescission to plaintiffs who under Section 14(a) challenged as fraudulent the proxy solicitation for a merger but were not parties to the merger agreement itself. Section 29(b) is equally applicable to cases arising under Section 10(b). *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 735 (1975). *Cf. Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 18-19 (1979) (recognizing a right to rescission for cases arising under the comparable language of Section 215 of the Investment Advisers Act, 15 U.S.C. § 80b-15). This section, however, may be invoked only when there has been a violation of another section of the securities laws which itself gives rise to a cause of action. *See* 3 L. Loss, *Securities Regulation* 1757-63 (2d ed. 1961); Gruenbaum & Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 Geo. Wash. L. Rev. 1, 4-5 nn. 12-13 (1979). And

the lower courts have held that an innocent party may seek rescission under § 29(b) subject to such equitable defenses as laches, waiver or estoppel. *Western Fed. Corp. v. Erickson*, 739 F.2d 1439, 1443-44 n. 5 (9th Cir. 1984).

In this case, petitioners' purchase of securities was induced by fraudulent misrepresentations contained in prospectuses. (*See* Appendix A, pp. 18a-19a, *infra.*) *See Myzel v. Fields, supra*, 386 F.2d at 742 (applying § 29(b) to a Rule 10b-5 case involving a sale of a security); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 391 (2d Cir. 1973), *cert. denied*, 414 U.S. 910 (1973) (recognizing rights to rescission for defrauded shareholder under § 29(b)); *see generally* Gruenbaum & Steinberg, *Section 29(b) of the Securities Exchange Act of 1934: A Viable Remedy Awakened*, 48 Geo. Wash. L. Rev. 1 (1979). Petitioners, thus, satisfy the contractual "privity" requirement implicit in Section 29(b). *See Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 557-63 (5th Cir. 1982).

II.

Delay in filing a suit does not bar the election of rescission when there is no benefit to the plaintiffs nor harm to the defendants.

In *Randall v. Loftsgaarden, supra*, 478 U.S. ____, 106 S. Ct. at 3155, this Court, without deciding the issue, noted that "some courts have barred plaintiffs from electing rescission, or a rescissionary measure of damages, where they delayed tender or suit *in order to increase their expected recovery should the market decline*." (Italics added.) This Court further noted, "[a] similar rule may well be appropriate where plaintiffs delay tender or suit in order to obtain additional tax benefits . . . ." *Id.* at 3155.

In general, courts have barred plaintiffs from the remedy

of rescission either when they delayed suit while avoidable damages accrue, *see, e.g., Stull v. Bayard*, 561 F.2d 429, 433 n. 4 (2d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); *Volk v. D.A. Davidson & Co., supra*, 816 F.2d at 1412-13; *Brigden v. Scott*, 456 F. Supp. 1048, 1060 (S.D. Tex. 1978); or when they delayed suit to speculate on changes in market price, *see, e.g., Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 532 (10th Cir. 1962); *Myzel v. Fields, supra*, 386 F.2d at 740-41 n. 15; L. Loss, *Fundamentals of Securities Regulation* 1133 n. 127 (1983) ("That is to say, the plaintiff cannot play the market at the defendant's expense."); Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349 369-70 (1984). These decisions either explicitly or implicitly, are based on the policies supporting the defenses of laches, waiver or estoppel, which have been recognized as available in securities fraud cases. *See, e.g., Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 213-14 (9th Cir. 1962); *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202, 1207-08 (9th Cir. 1970).

In contrast, the lower courts in this action created a far broader bar to electing rescission. As the District Court stated: "It is necessary for a party seeking rescission and restitution to act with all reasonable dispatch to preserve this remedy."[4] *Feldman*

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4. In this action, there was no benefit to be gained by the petitioners in delaying filing of suit until reception of an official notice from the IRS. If the Service considered—as it did in December 1975—the COPP loans to be a "sham," the petitioners' investment became unmarketable and essentially valueless. By delaying filing suit after the earlier receipt of correspondence from respondents' accountants that suggested the COPP loans might be viewed as impermissible, no "avoidable damages accrued." Had the IRS not viewed the transaction as a "sham" the petitioners could have spared themselves and the courts the expense of this litigation. As it was, promptly after receipt of the IRS notices, this action was commenced. The District Court concluded suit was commenced within the relevant statute of limitations. 606 F. Supp. at 920-22.

v. Pioneer Petroleum, Inc., 606 F. Supp. 916, 923 (W.D. Okla. 1985), *aff'd*, 813 F.2d 296, 301-02 n. 10 (10th Cir. 1987). This broader bar to electing rescission is also supported by *Baumel v. Rosen, supra*, 412 F.2d 571, 574; *Johns Hopkins University v. Hutton*, 488 F.2d 912, 915-16 n. 12 (4th Cir. 1973), *cert. denied*, 416 U.S. 916 (1974); *Gannett Co., Inc. v. Register Publishing Co.*, 428 F. Supp. 818, 827-28 (D. Conn. 1977).

Even at common law, where the failure to act promptly is most often termed "laches" (*see* Friedman, *Delay as a Bar to Rescission*, 26 Cornell L. Q. 426, 427 (1941)), there are strict limitations on the availability of that defense. As one leading commentator observed:

> The defense of laches, interposed to defeat the right to rescind a contract for fraud or other sufficient cause, should not be entertained unless it is made to appear that it would be inequitable to deny it . . . . Hence the cases generally agree that delay in taking steps to rescind a contract—even though so long-continued that otherwise it would amount to laches—will not prevent the granting of relief to the rescinding party where it is still possible to restore the other party to his former status, or where that status has not been changed, and where he has not been misled to his prejudice and will not be in any way injured by the rescission, and where no equities have intervened.

1 H. Black, *A Treatise on the Rescission of Contracts and Cancellation of Written Instruments* § 546 at 1348 (2d ed. 1929).

Similarly, Professor Williston in his treatise on contracts observed:

> Setting a fraudulent bargain aside, however, is an alternative right given on equitable principles to the injured party, and, therefore, if this remedy is desired, it must be sought with reasonable promptness after the fraud has been discovered . . . . "The question of how much time a party to a contract has permitted to elapse is not necessarily determinative of the right to rescind; the immediate consideration being whether the period has been long enough to result in prejudice to the other party."

12 S. Williston, *Contracts*, § 1526 at 622-24 (3rd ed. 1970), *quoting Brown v. Young*, 62 Ind. App. 364, 110 N.E. 562 (1915).

The lower courts' broad formulation of a "promptness" rule, moreover, contradicts the deterrence and unjust enrichment policies that this Court has emphasized in construing § 10(b) remedies. *See* Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349, 390-91 (1984). In effect, in this case, the trial court held that the respondents had committed securities fraud, but resolved all doubts against the petitioners, the innocent parties. Focusing on the defendants' fraud is particularly appropriate with laws such as the federal securities laws which serve important public purposes. This Court on several occasions has recognized the appropriateness of limiting common law barriers to enforcement of the federal securities laws. In *Batemen Eichler, Hill Richards, Inc. v. Berner, supra*, 472 U.S. 299, this Court limited the availability of the *in pari delicto* defense in a § 10(b) action. Relying on an antitrust action, *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134, 138 (1968), this Court emphasized "the inappropriateness of invoking broad common-law barriers to relief where a private suit serves important public purposes." *Id.* at 307, 310. *See also, A.C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38, 43 (1941).

Similarly, in *Herman & MacLean v. Huddleston, supra*, 459 U.S. at 388-89 (1983), this Court recognized "the antifraud provisions of the securities laws are not coextensive with common-law doctrine of fraud. Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry." Moreover, a promptness rule barring rescission when a plaintiff has not profited is also flatly inconsistent with the unjust enrichment theory articulated in *Randall v. Loftsgaarden, supra*, 478 U.S. ____, 106 S. Ct. at 3153 (1986), that "it is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them."

A promptness rule requiring plaintiffs to seek rescission "with all reasonable dispatch" even when there is no disadvantage to defendants or benefit to the plaintiffs also is inconsistent with principles of judicial economy. Inevitably, plaintiffs, concerned that they may not have filed suit with "all reasonable dispatch," will present evidence calculating "out of pocket" damages even if that is not the remedy sought out of concern that a trial court might hold that they forfeited their right to rescission.

III.

When a trial court finds that an investment was a "sham," evidence of out-of-pocket damages does not require further expert testimony.

If rescission is unavailable in an action arising under § 10(b), 15 U.S.C. § 78(b) actual damages may be sought under § 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb(a). This Court has generally applied an out-of-pocket measure of damages in § 10(b) cases, holding that ordinarily "the correct measure of damages under § 28 of the Act, 15 U.S.C. § 78bb(a), is the

difference between the fair value of all that the [plaintiff] received and the fair value of what he would have received had there been no fraudulent conduct." *Affiliated Ute Citizens v. United States*, 406 U.S. at 155; *Randall v. Loftsgaarden, supra*, 478 U.S. ____, ____, 106 S. Ct. 3143, 3152-53.

The Circuits are in some confusion as to how to calculate "the fair value of what [the plaintiff] would have received." Most Circuits, at times, including the Tenth Circuit, *see Feldman v. Pioneer Petroleum, Inc., supra*, 606 F. Supp. at 924 n. 5, calculate the value of a plaintiff's investment at the date of purchase. *See Wool v. Tandem Computers, Inc.*, 818 F.2d 1433, 1437 (9th Cir. 1987); *Letterman Brothers Energy Securities Litigation*, 799 F.2d 967, 972 (5th Cir. 1986), *cert. denied*, ____, U.S. ____, 107 S. Ct. 1373 (1987); *Harris v. Union Electric Co.*, 787 F.2d 355, 367-68 (8th Cir.), *cert. denied*, ____ U.S. ____, 107 S. Ct. 94 (1986). This measure of damages prevents a plaintiff from shifting to the defendant market risks. *See, e.g.*, Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 Vand. L. Rev. 349, 357-58 (1984).

These same Circuits, generally without acknowledging inconsistent opinions, however, have on occasion permitted reasonable inferences to be drawn from the value of an investment at the time of the discovery of a fraud as to what the earlier value would have been. *See Harris v. American Investment Co.*, 523 F.2d 220, 226-27 (8th Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976); *Richardson v. MacArthur*, 451 F.2d 35, 43-44 (10th Cir. 1971); *Esplin v. Hirschi, supra*, 402 F.2d at 104-05, *cert. denied*, 394 U.S. 928 (1969); *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 620 (9th Cir. 1981).[5] The rationale

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5. Alternatively, on a deterrence rationale, the Second Circuit has permitted damages to be calculated at the date or resale when a fraud was subsequently

(Cont'd)

for this inference is articulated in *Harris v. American Investment Co., supra*, which explained:

> There may be difficulty ascertaining the value of the article transferred in connection with a misrepresentation where the misrepresentation asserts the market price of the article . . . . Thus, where a defendant's fraudulent conduct is alleged, as it is in this case, to have caused an artificial market of long duration, damages have been fixed . . . not at the date of purchase but rather at the date of discovery of the fraud.

Id., 523 F.2d at 226 (relying on the Tenth Circuit decision in *Esplin v. Hirschi, supra*).

In a case with similar facts to the immediate action, the Fifth Circuit concluded that plaintiffs were entitled to damages based on the testimony of two plaintiffs "that the IRS had valued their Programs at zero and therefore had denied their deductions and credits." *Nottingham v. General American Communications Corp.*, 811 F.2d 873, 877 (5th Cir. 1987). *See also, Rowe v. Maremont Corp.*, 650 F. Supp. 1091, 1115 (N.D. Ill. 1986) (no expert testimony at trial concerning damages).

In contrast, the lower courts' more rigid insistence that expert testimony be introduced positing damages based on the value difference between the investment purchases and the price paid at the date of purchase, *see Feldman v. Pioneer Petroleum, Inc., supra*, 606 F. Supp. at 924 n. 5, goes far toward adoption of

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(Cont'd)
discovered. *See Chasins v. Smith Barney & Co.*, 438 F.2d 1167 (2d Cir. 1970); *see generally* 5C A. Jacobs, *Litigation and Practice Under Rule 10b-5* § 260.03(c)(iv) (2d ed. 1987).

a requirement that plaintiffs must prove damages "with mathematical precision." *Contrast King & King Enterprises v. Champlin Petroleum Co.*, 657 F.2d 1147, 1158 (10th Cir. 1981), *cert. denied*, 454 U.S. 1164 (1982). It flatly contradicts the teaching of *Affiliated Ute Citizens v. United States, supra*, 406 U.S. at 155 that "reasonable inferences may be drawn" in calculating damages, a latitude given expressly in light of the fact that the market there was "isolated" and "thin." *See also, Holmes v. Bateson*, 583 F.2d 542, 563 (1st Cir. 1978); *Glick v. Campagna*, 613 F.2d 31, 37 (3d Cir. 1979).

Allowing parties reasonable latitude to infer the value of an investment at the time of purchase is consistent with the policies enunciated in *Randall v. Loftsgaarden, supra*, 478 U.S. ____, 106 S. Ct. 3143. In *Loftsgaarden*, this Court reaffirmed its earlier holding in *Affiliated Ute Citizens v. United States, supra*, 406 U.S. at 155, that "where the defendant received more than the seller's actual loss . . . damages are the amount of the defendant's profit." This unjust enrichment theory was grounded in the rationale, "[i]t is more appropriate to give the defrauded party than to let the fraudulent party keep them." 478 U.S. at ____, 106 S. Ct. at 3153. It found further support from the deterrent purposes of the securities laws. "This deterrent purpose is ill-served by a too rigid insistence on limiting plaintiffs to recovery of their 'net economic loss.' " 478 U.S. at ____, 106 S. Ct. at 3154. As a general proposition, this Court underlined that § 28(a) has "flexible limits" to achieve these policies, 478 U.S. at ____, 106 S. Ct. at 3153.

Courts have generally been particularly willing to measure the value of securities at the time of purchase by inference from the date of discovery of a fraud when the transaction concerns privately offered securities. In that instance, there is no earlier market price that can be consulted. *See* Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort*

Damages, 37 Vand. L. Rev. 349, 361-62 (1984). When privately offered securities would have been unmarketable had the fraud been known, a post-fraud discovery date is particularly appropriate. A basic purpose of determining value at the date of purchase is to preclude "windfall recovery to a plaintiff in the nature of indemnification against the risks . . .of the market . . . ." *Bonime v. Doyle*, 416 F. Supp. 1372, 1384 (S.D.N.Y. 1976), *aff'd without op.*, 556 F.2d 554 (2d Cir. 1977), *cert. denied sub nom., Sloan v. Bonime*, 434 U.S. 924 (1977). But, where, as here, there is no possibility of market fluctuations redounding to the benefit of a plaintiff, rigid insistence on testimony as of the date of purchase is purely formal.

CONCLUSION

This Court is respectfully requested to grant a writ of certiorari to review the decision of the United States Court of Appeals for the Tenth Circuit.

Respectfully submitted.

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APPENDIX

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APPENDIX A—OPINION OF THE DISTRICT COURT

Jerome I. FELDMAN, et al.,

Plaintiffs,

v.

PIONEER PETROLEUM, INC., Frontier Corporation, The Estate of William D. Bradford, John H. Burgher, Fidelity Bank, N.A., The Estate of Grady D. Harris, Arthur Young & Company and James L. Houghton,

Defendants.

No. CIV 77-0012-R

United States District Court,
W.D. Oklahoma.

Feb. 28, 1985

Edward Labaton, Goodkind, Wechsler, Labaton & Rudoff, New York City, R.C. Jopling, Jopling & Blankenship, Oklahoma City, Okl., for plaintiffs.

Edward Little, White & Case, Martin Obermaier & Morvill, Silberfeld, Danziger & Bangser, New York City, James P. Linn, James A. Kirk, J.D. Helms, William P. Warden, Linn, Helms, Kirk & Burkett, J. William Conger, Hartzog, Conger & Cason, William G. Paul, Harry A. Woods, Jr., Brooke Smith Murphy, Michael M. Stewart, Earl A. Skarky, Crowe & Dunlevy, Oklahoma City, Okl., John Matson, New York City, Burck Bailey, Fellers, Snider, Blankenship, Bailey & Tippens, Oklahoma City, Okl., J. Stephen Welch, John H. Burgher, Jr., Schuman & Welch, P.C., Tulsa Okl., for defendants.

Appendix A

ORDER

DAVID L. RUSSELL, District Judge.

This action was commenced in 1976 in the United States District Court for the Southern District of New York and was subsequently transferred by agreement to the Western District of Oklahoma. The complaint seeks legal damages or in the alternative rescission and restitution based on violations of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5, and common law fraud. Initially, the Court determined that this case could be maintained as a class action. The class, however, was subsequently decertified, and the suit is now brought by some seventy investors who acquired limited partnership interests in the 1972 oil recovery program created by the late William D. Bradford. The sale of interests in the 1972 program was accomplished by Bradford and his fellow promoter, John H. Burgher[1] via the Prospectus,[2] a document entitled "Confidential Memorandum—William D. Bradford Partnership." This Prospectus was distributed to potential investors in New York and nine other states.

Under the plan as described in the Prospectus, each

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1. By agreement John H. Burgher was dismissed from this action in an Order dated April 29, 1983.

2. There were actually three prospectuses which were identical except that they related to the A-B Partnership, the C-D Partnership and the E-F Partnership respectively. Also in the A-B Partnership Prospectus Ronald Hill was listed as a reference; upon his resignation from Fidelity Bank the name of Fidelity President, Grady Harris was inserted in the C-D and E-F Partnership Prospectuses.

partnership would consist of Bradford, as the sole general partner, and a number of limited partners. Each partnership was to be divided into two tiers—a first-tier partnership and a second-tier partnership. The limited partners' investment in the first-tier would constitute the partnership's capital and would be used to purchase a working interest in an oil and gas lease from Pioneer Petroleum. The purchase price was intended to cover Pioneer's costs of drilling wells and other expenses. Approximately 90% of the capital contributed by the limited partners would be allocated by Pioneer to "intangible drilling and development costs." This would entitle each limited partner to deduct 90% of his investment for income tax purposes. Once the first-tier partnership leasehold had economic value, the second-tier would be created. According to the Prospectus, the general partner would arrange to finance the second-tier partnership's venture into oil development by selling a carved-out production payment ("COPP") for a price equal to the total capital contribution in the first-tier partnership. The COPP would be payable only out of the oil and gas revenues from the first-tier partnership's leasehold, and would be sold to an outside lender. The sale of the COPP would be analogous to a non-recourse loan. A limited partner participating in the second-tier partnerships would be entitled to another tax deduction of approximately 90% of his initial investment because the COPP funds would also be allocated to expenses and intangible drilling and development costs of the second-tier leasehold.

Thus, if a limited partner invested $10,000.00 in the first-tier partnership and elected to participate in the second-tier, the investor would receive income tax deductions in the amount of $18,000.00.

The Prospectus included an opinion letter regarding the tax consequences of the transaction. This letter, dated March 13, 1972,

was on the letterhead of Defendant Arthur Young and Company and signed by Defendant James L. Houghton.

The Plaintiffs contend that William D. Bradford made material misrepresentations in the Prospectus presented or shown to each investor in order to induce them to purchase limited partnerships, that they relied on the misrepresentations, and sustained damages as a result thereof.

Further Plaintiffs argue that the Arthur Young-James Houghton (hereinafter "AY-JH") opinion letter contained in the Prospectus was materially false and misleading in that (1) it failed to disclose the substantial risks to the tax deductions promised in the Prospectus, (2) it failed to disclose the substantial risks associated with obtaining a COPP loan from an outside lending source and (3) it failed to disclose the variance between the opinion letter's assumed facts and those facts set forth in the Prospectus. It is claimed that the association of AY, with its reputation as a Big Eight accounting firm, and James Houghton, with his reputation as an expert in oil and gas law, with the Bradford partnerships and the presence of the AY-JH opinion letter in the Prospectus served as legitimizers of the Program. Plaintiffs allegedly placed reliance on the opinon of AY and Houghton when considering a tax shelter investment in the Bradford Programs.

Plaintiffs allege that Fidelity Bank, N.A. (hereinafter "FBNA") aided and abetted Bradford's scheme in two ways. First, Ronald Hill, who in early 1972 was Vice President and the principal oil and gas lending officer at FBNA and who was in charge of the Bradford and Pioneer accounts, authorized the use of his name in the A-B Partnership Prospectus as a reference. In August, 1972, Hill resigned from FBNA and the name of Fidelity's President, Grady D. Harris, was substituted as a reference in the C-D and

Appendix A

E-F Partnership Prospectuses. Second, Plaintiffs contend that Harris,[3] as President of FBNA, executed a document dated September 25, 1972, that evidenced a payment of $800,000.00 to the A Partnership secured only by a COPP when in reality no monies had been advanced. Other transactions alleged to be shams occurred in October and December. On Friday, October 27, 1972, FBNA made an $800,000.00 loan to the A Partnership which was repayable on Monday, October 30, 1972. By COPP documents dated December 10, 1972, and executed by Harris, FBNA purported to advance $800,000.00 to the C-D Partnership and $800,000.00 to the E-F Partnership.

It is asserted that FBNA's role in carrying out a sham loan to the A-B Partnership was essential to the success of Bradford's scheme. It assured the successful selling of the C-D and E-F Partnerships because the loan to the A-B Partnership gave credibility to the other Bradford Programs. It is alleged that the sale of the loan was the primary reason investors purchased interests in the later partnerships.

In 1975, the Internal Revenue Service commenced a review of the Bradford Partnerships. As yet the resultant Tax Court litigation is unresolved.

The procedural posture of this action is as follows: In light of the fact that there are some seventy individual Plaintiffs who reside outside the Western District of Oklahoma and in view of the many issues requiring individual inquiry, the parties suggested the possibility of selecting several Plaintiffs who are representatives of the various groups of plaintiffs and presenting a trial of their

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3. Grady D. Harris died before the commencement of this lawsuit and thus the Estate was sued by Plaintiffs.

case in its entirety. Plaintiffs Jerome I. Feldman, Barry M. Brookstein, Albert E. Abraham and Albert A. Rettig were selected by all parties as representative of the various groups of investors.

I.

On the date of trial, April 24, 1983, counsel for the Estate of Grady D. Harris, Jr., presented a copy of a Final Discharge entered in the District Court of Oklahoma County in the matter of the Estate of Grady D. Harris, Jr., deceased, No. P-74-1736, dated July 15, 1981. Counsel then made an oral Motion to Dismiss the Estate as a party to this action.

Before the Final Discharge was entered, the co-executors gave the statutorily required notice but did not give personal notices to any of the Plaintiffs in this action. The question before the Court is whether the entry of the Final Discharge bars continuation of the present action as to the Estate.

The Oklahoma Supreme Court, in *Oberlander v. Eddington,* 391 P.2d 889 (Okla. 1964), held that a Decree of Distribution under a will entered after notice and hearing is conclusive as to the rights of all parties interested in the estate in the absence of fraud, mistake, or collusion. A Decree of Distribution is ordered upon the final settlement of the accounts of the executor or administrator under 58 O.S. § 631 (1981). Subsequently, after the estate has been fully administered and the executor has paid all money and delivered all properties to entitled parties, a Discharge of the Representative is entered. 58 O.S. § 691 (1981).

In *Burford v. Stuart,* 412 P.2d 169 (Okla. 1966), the Plaintiff did not perfect an appeal from the Order Approving the Final Account of the Executrix, which decreed distribution of the estate,

but appealed only from the subsequent order authorizing the discharge of the executrix. The Oklahoma Supreme Court concluded that since no appeal had been taken from the Order Approving the Final Account of the Executrix, such Order and decree were conclusive as against Plaintiff's rights as a contingent beneficiary of an insurance policy. It was determined that the executrix had fulfilled her duties, and was entitled to be discharged under 58 O.S. § 595 and § 691.

The Tenth Circuit has recognized Oklahoma's general rule of finality in *Droppleman v. Horsley,* 372 F.2d 249 (10th Cir. 1967)), an action based on alleged conspiracy in a probate matter. In disallowing what amounted to a collateral attack on the distribution of the estate, the Court stated:

> "[J]udgment [of the probate court] until reversed or vacated by the proper procedure in that court or some other tribunal of that state authorized thereto by its laws must be accepted here, not only to estop appellant to be heard on his allegations of fraud, [contained in a collateral complaint] but as a bar against the maintenance and prosecution of that complaint in this court."

Id. at 251 (quoting *Folk v. Monsell,* 71 F.2d 816, 818 (10th Cir. 1934)).

This Court is persuaded that the Final Discharge entered by the District Court of Oklahoma County is a final order adjudicating the rights of all parties having or seeking an interest in such Estate. It is equally clear that the Plaintiffs seek to obtain an interest in that Estate via this action. Consequently, proceeding with the present action as against the Estate would be allowing

a prohibited collateral attack upon the Final Discharge. *Droppleman, supra; Oberlander, supra; see also, Cox v. Mackenzie,* 70 Ariz. 308, 219 P.2d 1048 (1950).

Although it may seem a harsh result, the Plaintiffs have been aware that a party to the case at bar was in the probate court and could easily have kept abreast of those proceedings in order to prevent the entry of the Final Discharge. For the foregoing reasons, the Estate of Grady D. Harris, Jr., is dismissed with prejudice from this action.

II.

Commencing April 24, 1983, the Court heard the cases of the four test plaintiffs. At the outset of the trial, the parties raised the issue of the applicable statute of limitations with respect to Plaintiffs' federal securities fraud claims.

Plaintiffs contend that the statutes of limitations of the states where Plaintiffs sustained their losses are determinative, while Defendants support the application of Oklahoma's two-year period of limitations for fraud actions set forth in 12 O.S. § 95 (Third). In this regard, Plaintiffs maintain that even if the Oklahoma two-year statute governs, the action is timely since the Plaintiffs could not have learned of the alleged fraud more than two years prior to the commencement of this action.

It is agreed that no specific federal statute of limitations exists for suits brought under § 10(b). Thus, according to the U.S. Supreme Court in *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), such actions are subject to the limitations period applicable to fraud actions by the law of the forum state.

Appendix A

Plaintiffs suggest that in the Tenth Circuit the law of the state where the violation occurred governs with respect to limitations, citing *Hackbart v. Holmes,* 675 F.2d 1114 (10th Cir. 1982). Plaintiffs contend, without citation of authority, that the injury occurred where the payments for the limited partnership interests were made, and thus the statutes of limitations in the Plaintiffs' resident states should be followed.

On review, it appears that the law in the Tenth Circuit on this issue is somewhat unclear. In 1970, the Tenth Circuit held that "the limitations statutes of the forum state in which the alleged prohibited acts occurred applies." *deHaas v. Empire Petroleum Co.,* 435 F.2d 1223, 1225 (10th Cir. 1970). A year later the Court stated, "The settled rule is that where a federal statute is silent as to the appropriate period of limitations, the appropriate period of limitations of the forum state is applied." *Mitchell v. Texas Gulf Sulphur Co.,* 446 F.2d 90, 103 (10th Cir. 1971). In 1980, the statute of limitations "of the state where the alleged violation occurred" was applied in *Aldrich v. McCulloch Properties, Inc.,* 627 F.2d 1036, 1041 (10th Cir. 1980). In *Ohio v. Peterson, Lowry, Ralls, Barber & Ross,* 651 F.2d 687, 691 (10th Cir. 1981), the limitations period supplied by the law of the forum state was held applicable. Finally in *Hackbart v. Holmes, supra,* the Court stated that the appropriate statute is that "of the state in which the alleged violation occurred." at 1120. However, as Defendants note, the comment in *Hackbart v. Holmes, supra,* may be construed as dictum since there the parties had agreed that the Colorado statute of limitations for fraud applied. Thus, in light of *Hochfelder* and *Ohio v. Peterson, Lowry, Ralls, Barber & Ross, supra,* the statement in *Hackbart* perhaps should not be construed literally.

The Tenth Circuit decisions may be reconciled if they are read as holding that the forum state's law of limitations of actions

is applicable. However, application of Oklahoma law may require the Court to apply another state's statute of limitations.

Title 12 O.S. § 105 (1981), provides:

> "The period of limitation applicable to a claim accruing outside of this state shall be that prescribed either by the law of the place where the claim accrued or by the law of this state, whichever last bars the claim."

In *Brickner v. Gooden,* 525 P.2d 632 (Okla. 1974), the Oklahoma Supreme Court decided that where a tort claim accrued is determined by deciding which state has the most significant relationship to the occurrence and the parties. In this regard, the Oklahoma Supreme Court held:

> The factors to be taken into account and to be evaluated according to their relative importance with respect to a particular issue, shall include:
>
> (1) The place where the injury occurred,
>
> (2) the place where the conduct causing the injury occurred,
>
> (3) the domicile, residence, nationality, place of incorporation and place of business of the parties, and
>
> (4) the place where the relationship, if any, between the parties occurred.

Id. at p. 637.

The process is one of "counting the relevant contact points of each state, and applying the law of that state which has the greatest number." Note, "Oklahoma's Borrowing Statute," 2 Okla. City U.L.Rev. 107, 115 (1977).

The Plaintiffs argue that the place where injury occurred is where Plaintiffs paid for the limited partnerships; in other words, in each of the ten states where Plaintiffs reside.[4] The first factor becomes of lesser importance when "such as in the case of fraud and misrepresentation . . ., there may be little reason in logic or persuasiveness to say that one state rather than another is the place of injury." *Restatement (Second) of Conflicts of Laws* § 145 comment (e) on subsection (2) (1969).

With respect to the second factor, the conduct causing the alleged injury appears to have occurred in Oklahoma since the Prospectus and the Arthur Young opinion letter were prepared in Oklahoma, and the Fidelity loan arranged in Oklahoma.

The third factor deals with the residences of the parties. As previously stated Plaintiffs' residences are scattered amongst ten states. However, the Defendants are two Oklahoma corporations, an Oklahoma bank, two deceased residents of Oklahoma whose estates are being administered in Oklahoma courts by Oklahomans,

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4. New York is the predominant state of residence for the Plaintiffs. However, New York is an inappropriate forum as Oklahoma will not borrow the limitations law of a jurisdiction in which the Defendant cannot be summoned. *Western Natural Gas Co. v. Cities Service Gas Co.*, 507 P.2d 1236, at 1243 (Okla. 1972) appeal dism., cert. denied, 409 U.S. 1052, 93 S.Ct. 559, 34 L.Ed.2d 506 (1972). In this regard it is evidenced that Defendant Fidelity Bank cannot be sued anywhere except Oklahoma. *See* 12 U.S.C. § 94; *see also Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 96 S.Ct. 1989, 48 L.Ed.2d 540 (1976).

two living residents of Oklahoma, and a national accounting firm, whose alleged wrong-doing arises out of its Oklahoma offices.

Clearly, the second and third factors weigh heavily in favor of Oklahoma.

The fourth factor to be considered is the place where the relationship between Plaintiffs and Defendants arose. It appears that the Bradford partnerships were Oklahoma limited partnerships. The partnership accounts were maintained in Oklahoma. In addition the Plaintiffs' claims concern transactions involving oil and gas wells drilled in Oklahoma.

On review and consideration of the foregoing facts the Court is persuaded that Oklahoma is the state with the most significant relationship to the occurrence and to the parties and thus its two-year statute of limitations shall apply to the Plaintiffs' federal securities claims and their common law fraud claims.

In this regard, the Court finds that the statute as it pertains to both causes of action "begins to run when the aggrieved party discovers, or should have discovered by the exercise of reasonable diligence, the facts constituting the fraud." *Aldrich v. McCullough Properties, Inc.*, 627 F.2d 1036, 1041 (10th Cir. 1980) (securities claims); *In re Woodward,* 549 P.2d 1207, 1208-9 (Okla. 1976) (common law fraud claims); 12 O.S.1981 § 95(3).

The parties agree that the statute was tolled from the date the class action was filed, March 26, 1976, to May 7, 1981, when Judge Daugherty decertified the class. This Court also finds that decertification acted as a dismissal not on the merits and, therefore, the Oklahoma "saving statute" is applicable to the common law fraud claims, 12 O.S.1981 § 100, and to the federal securities

claims. *Cf. Woosley v. Hi-Plains Harvestore, Inc.*, 550 F.Supp. 161 (W.D. Okla. 1981). Under the facts as presented via the four test Plaintiffs, the Court finds that the letters sent to the limited partners by Hurdman & Cranstoun in June, 1974, triggered the statute. Therefore, the application of § 100 has the effect of enlarging the two year limitation period as to the four test Plaintiffs. An examination of the record reveals that the claims of the four test Plaintiffs are not barred by the statute of limitations.

III.

At the close of the Plaintiff's case, all the Defendants moved to dismiss pursuant to Rule 41(b), Federal Rules of Civil Procedure. In considering whether to grant Defendants' motions, the Court has wider latitude than in considering whether to direct a verdict in a jury trial. In a non-jury trial the Court is the trier of the facts and may weigh and consider the evidence. 5 Moore's Federal Practice ¶41.13[4] p. 41-193. The Tenth Circuit has noted in *Olsen v. Progressive Music Supply, Inc.*, 703 F.2d 432, 436 (10th Cir. 1983) that "[t]he fact finding process under a Rule 41(b) motion calls for an adjudication upon the merits of the plaintiff's claims and may involve a weighing of the evidence as it stands at the close of the plaintiff's case." In *Blankenship v. Herzfeld*, 661 F.2d 840, 845 (10th Cir. 1981), the Court held that " '[i]n a case tried without a jury, the trial court is not required to consider the evidence in the light most favorable to the plaintiff in determining whether to grant a motion to dismiss under Rule 41 made at the completion of the plaintiff's case.' " (quoting *Woods v. North American Rockwell Corp.*, 480 F.2d 644, 645-6 (10th Cir. 1973)).

Before determining the purely evidentiary questions, the Court

will first address whether the equitable relief requested is available to the Plaintiffs. It is necessary for a party seeking rescission and restitution to act with all reasonable dispatch to preserve this remedy. *Gannett Co., Inc. v. Register Pub. Co.*, 428 F.Supp. 818 (D. Conn. 1977); *Ehrler v. Kellwood Co.*, 391 F.Supp. 927 (E.D. Mo. 1975); *aff'd.* 521 F.2d 1347 (8th Cir. 1975); *Hickman v. Groesbeck*, 389 F.Supp. 769 (D. Utah 1974). The Court has already determined that the four test Plaintiffs had information sufficiently suggestive of the alleged fraud by June, 1974. There was no evidence presented to the Court to indicate the Plaintiff's sought rescission and restitution from Bradford prior to the filing of this action in March, 1976. "Where parties have the right to rescind, they cannot delay the exercise of that right to determine whether avoidance or affirmance will be more profitable to them." *Hickman*, 389 F.Supp. at 780. The Court finds the Plaintiffs did not act with all reasonable dispatch as nearly two years elapsed prior to their seeking this relief. Consequently, they have forfeited this remedy.

The Defendants forcefully contend that no legal relief is available as the Plaintiffs have not suffered any actual damages. Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a), bars recovery under the Act of any amount "in excess of [a plaintiff's] actual damages." *Estate Counseling Services, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962). Thus, the customary measure of damages in a § 10(b) action is a plaintiff's out-of-pocket loss. *Hackbart v. Holmes*, 675 F.2d 1114 (10th Cir. 1982).

It is clear that the tax advantage received by a plaintiff is an appropriate consideration in evaluating actual damages in a tax shelter case such as this. "The actual damages principle requires that a rescissional or restitutional award be 'reduced by any value

received as a result of the fraudulent transaction.' " *Austin v. Loftsgaarden,* 675 F.2d 168, 181 (8th Cir. 1982) (quoting *Garnatz v. Stifel, Nicolaus & Co.,* 559 F.2d 1357, 1361 (8th Cir. 1977), *cert. denied,* 435 U.S. 951, 98 S.Ct. 1578, 55 L.Ed.2d 801 (1978)); *see also Bridgen v. Scott,* 456 F.Supp. 1048, 1061 (S.D. Tex. 1978).

There is a serious question whether the Plaintiffs in this case have suffered any damage whatsoever as a result of investing in the Bradford Partnerships.

The evidence demonstrated that each of the four test plaintiffs deducted 180% of his investment in the partnerships. Thereafter, in 1975, the Internal Revenue Service audited the investors deductions and found that a valid COOP loan had not been acquired and that the tax shelter was a sham. However, to date none of the investors has been required to pay any additional taxes with respect to their 1972 federal income tax returns.[5] In fact, according to Plaintiff Rettig's testimony all the tax disputes involving investors in the Bradford Partnerships have been designated by the IRS as "settlement vehicles". This means that the IRS is attempting to settle the disputes by offering to allow 100% of each investment as a deduction to the investor.

Plaintiff Feldman stated that his $200,000.00 investment has provided him with approximately $280,000.00 in tax benefits and cash income ($250,000.00 in cash retained due to the tax benefits;

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5. While the Court might have been receptive to factoring in the investors attorney's fees in tax court, no evidence on this element of damage was introduced. Additionally, as early as December 31, 1980, this Court indicated its willingness to consider damages based on the value difference between the investment purchased and the price paid, however, no expert testimony was introduced positing such valuations.

$30,000.00 income[6] from the investment). Thus, in effect, Feldman has retained an $80,000.00 profit.

If Plaintiff Feldman settled his tax dispute, he would be allowed a deduction of $200,000.00 rather than the $360,000.00 he claimed. The result would be $140,000.00 in cash retained due to the tax benefits, and $30,000.00 income from the investment, giving him a return of $170,000.00 on his $200,000.00 investment. Thus, he would sustain $30,000.00 in damages as a result of his investment. However, such damages are purely speculative at this point as no settlement has yet occurred.

The Court concludes that the Plaintiffs have failed to prove they have suffered actual loss even though the tax benefits promised in the Prospectus may not materialize.[7] Consequently,

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6. The Plaintiffs concede that they have received a cash return on their investments although it is estimated at a trivial 15-20% of their total investment over ten years. It is uncontroverted that the partnerships have ceased to produce any income and are not saleable at this time.

7. AY-JH further argues that even if Plaintiffs could prove damages they could not recover those losses from Arthur Young or James Houghton. An element of any § 10(b) damage claim must be "loss causation" meaning that a causal connection must exist between the misrepresentations and the economic harm complained of. *Croy v. Campbell,* 624 F.2d 709, 714 (5th Cir. 1980). It is AY & JH's position that any loss which occurred was caused from the failure to drill successful oil and gas wells. AY-JH maintain that they gave no assurance as to the success of the drilling venture and thus any losses arising from the unprofitable partnerships were not suffered as a proximate result of the allegedly misleading statements of AY-JH.

The Court rejects this theory since a large protion of damages if any would be sustained as a result of the IRS disallowance of the 180% deduction, and Plaintiffs contend that AY-JHs misrepresentations induced them to invest in the partnerships by supporting the validity of the 180% deduction.

the Court grants the Defendants' Motions to Dismiss as the Plaintiffs have failed to prove an essential element of both their securities claim and their common law fraud claim.

Although this finding is dispositive of the present action in its entirety, the Court will also address the Plaintiffs' proof on other elements as to each Defendant.

IV.

In order for the Plaintiff's to prevail against a primary violator of § 10b and Rule 10b-5, they must prove by a preponderance of the evidence the following:

> 1. that the conduct complained of occurred in connection with the purchase or sale of a security,
>
> 2. that the violator made an untrue statement of a material fact, or failed to state a material fact which was necessary in order to make the statements which were made not misleading,
>
> 3. that the violator acted knowingly, with a motive embracing intent to deceive, manipulate, or defraud; or with recklessness such as would be considered an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the actor or so obvious that he must have been aware of it,
>
> 4. that Plaintiff relied on such misrepresentation, and

5. that the Plaintiff was damaged as a proximate result of such misrepresentation.

Woodward v. Metro Bank of Dallas, 522 F.2d 84 (5th Cir. 1975); *Stevens v. Vowell,* 343 F.2d 374 (10th Cir. 1965).

It is also possible for the Plaintiff to recover against certain Defendants if they can establish such Defendants were aiders and abettors to the primary violator. To establish aider and abettor liability, the Plaintiffs must show:

1. fraud by the primary violator,

2. knowledge of the fraud by the aider and abettor, and

3. substantial assistance by the aider and abettor.

Hackbart v. Holmes, 675 F.2d 1114 (10th Cir. 1982); *Edwards & Hanly v. Wells Fargo Securities Clearance Corp.,* 602 F.2d 478 (2nd Cir. 1979), *cert. denied,* 444 U.S. 1045, 100 S.Ct. 734, 62 L.Ed.2d 731 (1980); *Zabriskie v. Lewis,* 507 F.2d 546 (10th Cir. 1974).

After careful consideration of the Plaintiffs' presentation and the Defendants' through cross-examination, the Court makes the following findings as to each Defendant in light of the above stated case law.

1. William D. Bradford:

The Plaintiffs have shown by a preponderance of the evidence that the prospectus produced and disseminated by Bradford for

the purpose of selling the limited partnerships was materially misleading subsequent to Pioneer's purchase of the COPP loan via Fidelity; that the appearance of a COPP loan from an outside lender served to enhance the saleability of the partnerships and was relied upon by the Plaintiffs in their decision to purchase; that Bradford acted knowingly with an intent to deceive subsequent purchasers as to the viability of obtaining an outside lender.

However, in light of the Court's finding on the issue of damages, the Motion to Dismiss by Defendant Bradford is granted.

2. Pioneer Petroleum, Incorporated:

The Plaintiffs have shown by a preponderance of the evidence that Pioneer via Bradford is liable as a primary violator. However, in light of the Court's finding on the issue of damages, the Motion to Dismiss by Defendant Pioneer is granted.

3. Fidelity Bank, N.A.:

The Court finds that while Harris was not involved in the planning or dissemination of the Bradford Prospectus the preponderance of the circumstantial evidence indicates he was aware of the existence of the Prospectus, and the investment nature of the program. Further, the evidence, at this stage of the litigation, indicates that Harris rendered substantial assistance to the fraudulent scheme by creating the appearance of a valid COPP loan. The various and sundry methods employed by Harris in creating this image evidence an extreme departure from ordinary care.

Consequently, the Court is of the opinion the Plaintiffs have shown that Fidelity is liable as an aider and abettor having

established fraud by Bradford, Harris' substantial assistance to the primary violator, and a recklessness by Harris that amounts to culpable scienter. However, in light of the Court's finding on the issue of damages, Fidelity's Motion to Dismiss is granted.

4. James L. Houghton and Arthur Young & Company:

The Plaintiffs claim these Defendants are primarily liable because the Opinion Letter contained in the Prospectus was materially false and misleading in the following ways:

(1) it failed to disclose the substantial risks to the tax deductions promised in the Prospectus;

(2) it failed to disclose the substantial risks associated with obtaining the COPP loan from a lending source and,

(3) it failed to disclose the variance between the Opinion Letter's assumed facts and those set forth in the Prospectus.

With regard to disclosure of the risks in obtaining the tax deduction, the Plaintiffs urge that Rev. Ruling 72-135 was pertinent to the proposed transaction. The Court finds that Rev.Ruling 72-135 deals with a factual situation dissimilar to the present case, as the Opinion Letter points out. It does not deal with COPP loans from a general partner to a limited partner, but with a non-recourse loan from a general partner to a limited partner to fund part of the latter's subscription price. Additionally, any conflict in tax treatment of the transaction would be governed by 26 U.S.C. § 636(a),[8] rather than by Rev.Ruling 72-135 because a revenue

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8. 26 U.S.C. § 636(a) (1972):

(Cont'd)

ruling which "operates to create a rule out of harmony with the statute is a mere nullity." *Manhattan General Equipment Co. v. Commissioner,* 297 U.S. 129, 134, 56 S.Ct. 397, 400, 80 L.Ed. 528 (1936). Consequently, information based on 72-135 would have been inapposite and immaterial to the investor. Plaintiffs also contend that the case of *Bernuth v. Commissioner,* 57 T.C. 225 (1971), *aff'd,* 470 F.2d 710 (2nd Cir. 1972), should have been discussed in the Opinion Letter as it related to the possibility of obtaining a deduction of 180%. *Bernuth,* simply stated, held that when a drilling contract is done on a turnkey basis, the taxpayer may have to come forward and prove the reasonableness of the drilling deductions. Once again, the scenario presented by Bradford to Houghton, and on which he was to base his opinion, said nothing about the type of drilling contract between Pioneer and Frontier or the amount Bradford would suggest the limited partners allocate to intangible drilling costs. The Court finds Houghton was not obliged to unduly broaden the scope of the Opinion Letter by discussing or seeking out aspects on which no advice had been sought. In so saying, the Court does not indicate that it would condone an accounting firm's avoidance of obviously pertinent

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(Cont'd)

Income tax treatment of mineral production payments

(a) Carved-out production payment.—A production payment carved out of mineral property shall be treated, for purposes of this subtitle, as if it were a mortgage loan on the property, and shall not qualify as an economic interest in the mineral property. In the case of a production payment carved out for exploration or development of a mineral property, the preceding sentence shall apply only if and to the extent gross income from the property (for purposes of section 613) would be realized, in the absence of the application of such sentence, by the person creating the production payment.

issues. However, the Court does not expect the author of an opinion letter to assume fraud by the promoter and accordingly fill such a letter with all information in any way tangential to the question posited. *Cf., Croy v. Campbell,* 624 F.2d 709 (5th Cir. 1980) (Plaintiffs urged court to adopt position that tax attorney's failure to investigate demonstrated recklessness. "The mere fact that [tax attorney] made tax analysis based upon information presented to him, was not an extreme departure from the standards of ordinary care." *Id.* at 715); *Mendelsohn v. California Underwriters, Inc.,* 490 F.Supp. 1069 (N.D. Cal. 1979) (Court held accountants had no duty to prospective investors to disclose knowledge, if any, where they did not attempt to use any inside information to trade for their own account, and did not substantially assist fraud in question. *Id.* at 1086-87); *SEC v. Haswell,* [1979-1980 Transfer Binder] Fed.Sec.L.Rep. (CCH) § 97, 156 (W.D. Okla. 1977) (Bond counsel under no duty to insist upon review of offering circular in final form, nor under a duty to withdraw opinion from circular when facts known to him were insufficient to put him on notice of fraud). In sum, the Court finds that the Opinion Letter was, by its express terms, very limited in scope, and that the conclusion reached had a reasonable basis in law. *Cf., Anderson v. Helvering,* 310 U.S. 404, 60 S.Ct. 952, 84 L.Ed. 1277 (1940); *Brountas v. Commissioner,* 692 F.2d 152 (1st 1982); *Dillingham v. United States,* 81-2 U.S. Tax Cas. (CCH) ¶9601 (W.D. Okla. 1981); 26 U.S.C. § 636(a).

The second category of omissions focuses on the risks of obtaining a COPP loan. Page two of the Prospectus expressly states the risks involved in successfully completing the oil recovery program. Also outlined are post-production problems and other economic factors which could render the well uneconomic. It seems almost too elementary to state, given the credentials of these

Plaintiffs, that one could not carve out a production payment from a well which was not economical. Nevertheless, the Plaintiffs contend the Opinion Letter should have contained words to this effect. The Court finds the Prospectus adequately sets forth the risk in obtaining a COPP, and the Opinion Letter did not need to contain duplicative information.

In this same category, the Plaintiffs also urge the Opinion Letter should have disclosed the following details regarding the COPP: (1) that before making a COPP loan a lender would require more data than is available prior to drilling, (2) that no commitment had been made by a lending source prior to the drilling, and (3) that neither Pioneer nor Bradford could afford to make the COPP loan. The Prospectus states that "[r]eservoir data required to fully evaluate the feasibility of waterflooding the subject properties are of poor quality and very limited quantity." The Court wonders how an investor could think a lender would commit to a COPP loan prior to drilling when the projected feasibility of the entire project was based on such data, or that additional data subsequent to drilling would not be essential. Nevertheless, the Court finds that once again the Plaintiffs seek to have these Defendants include the irrelevant as it pertains to the Opinion Letter fact scenario, and the obvious as regards the risks of the program. Lastly, it was Bradford who promised an outside lender. This Court has already found that the Plaintiffs relied on that represenation. Therefore, failure to address whether Pioneer or Bradford could afford to make the COPP loan would be an immaterial omission.

The final omission alleged is failure of the Opinion Letter to point out the variance between it and the Prospectus regarding the lending source. The Court finds this allegation substantially the same as the last one mentioned by the Plaintiffs in their second

group of alleged omissions. The variance was obvious; the fact scenario of the Opinion Letter was not the one relied on; failure to point out the variance was an immaterial omission.

Aider and abettor liability against these Defendants is premised primarily on the same facts. The Court finds that the Opinion Letter, which is not materially misleading, did not render substantial assistance to the primary violator. Additionally, the Court finds that Houghton did not render substantial assistance by recommending and contacting a local law firm on Bradford's behalf to draft the COPP documents. Secondary liability also fails for lack of scienter. The Court finds that knowledge of the primary fraud, or recklessness which would suffice for such scienter, was not established by a preponderance of the evidence as to these Defendants.

The Court is not holding James Houghton and Arthur Young & Company liable for the representations made throughout the Prospectus. While there was some evidence that Houghton made a change in the last draft of the Prospectus, there was no evidence that he was ever asked to, or did in fact, render an opinion on the entire plan as proposed by Bradford.

For the foregoing reasons, and in light of the Court's finding on the issue of damages, the Motion to Dismiss by Defendants James Houghton and Arthur Young & Company is granted.

5. Frontier Corporation:

The Court finds that Bradford was not representing Frontier while promoting the 1972 partnerships; that Frontier was not involved in the planning and promotion of the Prospectus; that Frontier made no statements whatsoever regarding the tax aspects

or financial arrangements pertaining to the drilling activities of Bradford; that, in the context of aider and abettor, Frontier's participation in the Bradford partnerships was limited to conducting drilling operations on the oil and gas leases which did not substantially assist Bradford in the perpetration of the fraud via the COPP loan. Therefore, Frontier's Motion to Dismiss is granted.

The Plaintiffs' common law fraud claims, which must be established by clear and convincing evidence, *Barnett v. Life Insurance Co. of the Southwest,* 562 F.2d 15 (10th Cir. 1977); *Barriner v. Stedman,* 580 P.2d 514 (Okla. 1978), fail for the same reasons given as to each Defendant on the Plaintiffs' securities action.

Summation

The Court has determined that the Oklahoma statute of limitations applies to the Plaintiffs' securities and common law fraud claims; that the claims of the four test Plaintiffs are not barred by the statute of limitations; that the present action would be a collateral attack on a final order and, accordingly, dismisses the action with prejudice as to the Co-executors of the Estate of Grady H. Harris, Jr.; that the Plaintiffs' proof has failed to establish liability as to James Houghton, Arthur Young and Company, and Frontier Corporation, and the Court dismisses the action with prejudice as to these Defendants for that reason; however, the Court dismisses the action as to each Defendant, including a dismissal with prejudice as to William D. Bradford, Pioneer Petroleum, Incorporated, and Fidelity Bank, N.A., on the basis of the Plaintiffs' failure to establish damages.

APPENDIX B — OPINION OF THE COURT OF APPEALS

Jerome I. FELDMAN and Martin M. Pollack, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

PIONEER PETROLEUM, INC.; Frontier Corporation; the Estate of William D. Bradford; Fidelity Bank, N.A.; and Alice June Harris,

Defendants-Appellants.

Securities and Exchange Commission; Norman C. Cross, Jr., and Cross & Company, Amici Curiae.

No. 85-1432

United States Court of Appeals,
Tenth Circuit.

March 5, 1987

Edward Labaton (Linda Nussbaum, John H. Riley of Goodkind, Wechsler, Labaton & Rudoff, New York City, and R.C. Jopling of Jopling & Blankenship, Oklahoma City, Okl., with him on the briefs) of Goodkind, Wechsler, Labaton & Rudoff, New York City, for plaintiffs-appellants.

B. J. Rothbaum, Jr. (Brinda K. White, with him on the brief) of Linn & Helms, Oklahoma City, Okl., for defendant-appellee Fidelity Bank, N.A.

Appendix B

Burck Bailey, Fellers Snider Blankenship Bailey & Tippens, Oklahoma City, Okl., for defendant-appellee Alice June Harris.

Daniel D. Boland of Hartzog, Conger & Cason, Oklahoma City, Okl., filed a brief for defendants-appellees Pioneer Petroleum, Inc. and Estate of William D. Bradford.

Richard Kirby, Asst. General Counsel (Daniel Goelzer, General Counsel, Jacob Stillman, Associate General Counsel, Marcha McNeely, Atty., and Paul Gonson, Solicitor, with him on the brief), S.E.C., Washington, D.C. for amicus Curiae U.S. S.E.C.

B. Hayden Crawford (Mary N. Birmingham, Tulsa, Okl., with him on the brief) of Crawford, Crowe & Bainbridge, P.A., Tulsa, Okl., for amici curiae Norman C. Cross, Jr. and Cross & Co.

Before BARRETT and TACHA, Circuit Judges, and BROWN, District Judge.*

WESLEY E. BROWN, Senior District Judge.

Plaintiffs appeal from a judgment entered pursuant to an order of the District Court, sitting without a jury, which granted defendants' Rule 41(b) motion for involuntary dismissal at the close of plaintiffs' case-in-chief on their federal securities fraud claims as well as the related common law fraud claims. Plaintiffs Jerome Feldman, Harvey Kushner, and Martin Pollack brought this suit as a class action on behalf of themselves and all other

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* Honorable Wesley E. Brown, United States District Senior Judge for the District of Kansas, sitting by designation.

similarly situated investors who had invested during 1972 in a number of related limited partnerships designed to engage in the exploration for and production of oil and gas in the State of Oklahoma. In their complaint, plaintiffs charged that defendants[1] had violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78j(b), Securities and Exchange Commission Rule 10b-5, 17 C.F.R. Sec. 240.10b-5, and common law principles of fraud. Plaintiffs sought legal damages or in the alternative rescission and restitution.

Initially, the District Court determined that the plaintiffs' suit could be maintained as a class action. The class, however, was subsequently decertified. The putative class members who had acquired similar interests in the limited partnerships were allowed to intervene. At a pre-trial conference, counsel agreed to a set of trial procedures which allowed the parties to try this litigation as if it were a class action. Both sides agreed that plaintiffs were to select several investors whose claims were representative of the various groups of investors and that they were to present their claims in their entirety. ROA, Vol. VIII, at 2580. At the conclusion of the plaintiffs' case-in-chief, the District Court would consider any appropriate motions by defendants for involuntary dismissal of the plaintiffs' claims on their merits under Rule 41(b), F.R.Civ.P. Plaintiffs Jerome Feldman, Barry Brookstein, Albert Abraham, and Albert Rettig were selected as representatives of the various groups of investors. Counsel for plaintiffs also stipulated at the close of the plaintiffs' case-in-chief that an adverse

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1. Defendants were: Pioneer Petroleum, Inc., Frontier Corp., The Estate of William D. Bradford, John H. Burgher, Fidelity Bank, N.A., The Estate of Grady Harris, Arthur Young & Company and James Houghton. Plaintiffs dismissed John H. Burgher as a defendant during the trial.

ruling by the District Court on the merits of the claims of these four "test" plaintiffs also applied to the remaining plaintiffs. ROA, Vol. XXVIII at 878-886.

The District Court sustained the defendants' motion to dismiss under Rule 41(b), F.R.Civ.P., in an order reported in 606 F.Supp. 916 (1985). The District Court found that the plaintiffs were aware of, but had failed to preserve their claims diligently in the probate proceedings on The Estate of Harris in an Oklahoma state probate court. The District Court dismissed the plaintiffs' claims against The Estate of Harris because it concluded that the state probate court had entered a "final order adjudicating the rights of all parties having or seeking an interest in such Estate." 606 F.Supp. at 920. The District Court declined to consider the remedy of rescission and restitution, finding that the plaintiffs had not acted "with all reasonable dispatch to preserve this remedy." *Id.* at 923. The District Court also found that the plaintiffs failed to present any evidence to support their claims for out-of-pocket damages. *Id.* at 923-24 & n. 5. It dismissed the plaintiffs' claims against the defendants-appellees, concluding that such a lack of proof on damages was "dispositive of the present action in its entirety." *Id.* at 924.

For reversal, plaintiffs have assigned four errors for review.[2] First, the District Court erred in applying an inappropriate legal standard in determining damages in a Rule 10b-5 case. Second, the District Court erred in rejecting their alternative claim for the equitable remedy of rescission and restitution. Third, the District Court erred in concluding that a final probate court order barred the plaintiffs from asserting their claims against The Estate

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2. Plaintiffs did not appeal the dismissal as to defendants Arthur Young & Company and James Houghton.

of Harris in this action. Fourth, the District Court erred in decertifying the class.

Because this appeal arises from a final order of dismissal under Rule 41(b), F.R.Civ.P., we believe that the plaintiffs have erroneously focused their contentions upon their view that the District Court entered a finding on the liability issue in their favor.[3] Rule 41(b), F.R.Civ.P., provides, in pertinent part, that

> (a)fter the plaintiff, in an action tried by the court sitting without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence. If the court renders judgment on the merits against the plaintiff, the court shall make findings as provided in Rule 52(a).

The purpose of Rule 41(b) is to permit a defendant to move for judgment in his favor "when the district court, even before

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3. Plaintiffs argue that counsel for the defendant Fidelity Bank stated to the District Court that Fidelity Bank would waive its right to present evidence even though the District Court denied the defendants' Rule 41(b) motion to dismiss. ROA, Vol. XXVIII, at 886-887. Under the posture of this litigation, after the District Court granted the defendants' Rule 41(b) motion at the close of the plaintiffs' case-in-chief, it is immaterial to argue whether or not any additional evidence offered by the defendant would affect the District Court's decision in entering a judgment for Fidelity Bank.

hearing the defendant's evidence, determines that the plaintiff has failed to offer persuasive evidence regarding the necessary elements of his case." *duPont v. Southern National Bank of Houston,* 771 F.2d 874, 879 (5th Cir. 1985), *cert. denied,* ____ U.S. ____, 106 S.Ct. 1467, 89 L.Ed.2d 723 (1986). It is clear that Rule 41(b) allows a district court to "dismiss the plaintiff's claim but does not allow it to render judgment in favor of the plaintiff." *Id.* The question we find dispositive in reviewing this appeal from a final order dismissing the plaintiffs' claims on their merits is whether or not the District Court erred in finding that the plaintiffs failed to prove all of the necessary elements under the federal securities law and common law fraud principles.[4] We agree with the District Court that the record discloses that the plaintiffs offered no competent evidence throughout the eight-day bench trial of their case in its entirety to satisfy the burden of proving their claims for damages. We affirm.

We will set out those substantially uncontroverted facts, as found by the District Court, which are essential to an understanding of our decision on the dispositive question before us. In 1972, William D. Bradford, who died before the trial, and John Burgher organized, promoted and sold limited partnership interests for the purpose of exploration for and development of oil and gas from leaseholds located within the State of Oklahoma.

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4. In deciding a Rule 41(b) motion which calls for an adjudication upon the merits of the plaintiff's claim, the district court undertakes the fact finding process which involves a weighing of the evidence and an assessment of the credibility of the witnesses to determine whether or not the plaintiff has demonstrated a factual and legal "right to relief." On review of a district court's grant of a Rule 41(b) motion, we examine the propriety of the court's factual findings under the "clearly erroneous" standard. *Olsen v. Progressive Music Supply, Inc.*, 703 F.2d 432, 436 (10th Cir.), *cert. denied*, 464 U.S. 866, 104 S.Ct. 197, 78 L.Ed.2d 172 (1983).

Appendix B

Under the plan of operation, as described in a prospectus document entitled "Confidential Memorandum—William D. Bradford Partnership," each partnership would consist of Bradford as the sole general partner and a number of limited partners who invested in that partnership. Each partnership was to be divided into two tiers—a first-tier partnership and a second-tier partnership. The limited partners' investment in the first-tier would consist of the capital investment of the limited partners. It would be used to purchase from Pioneer Petroleum, Inc., a working interest in an oil and gas lease and to cover Pioneer's costs of drilling oil and water injection wells, puchase of equipment, and other expenses under an operating agreement in which Pioneer agreed to drill all wells on a turnkey basis.[5] Approximately 90% of the capital contributed by the limited partners would be allocated to "intangible drilling and development costs." This would provide the basis for each limited partner to claim a deduction of 90% on his investment for income tax purposes. When it was established that the leasehold involved in the first-tier partnershp had an economic value, the general partner would arrange to finance further development by selling on a non-recourse basis a carved-out production payment ("COPP"), payable out of 100% of the oil and gas revenues from the first-tier partnership's working interest in that leasehold, to an outside lending source for a price approximately equal to the total capital contribution in the first-tier partnership. For tax purposes, the sale of the COPP would be analogous to a non-recourse mortgage (loan). At the option of the limited partner, the COPP loan funds received by the partnership would be used by the general partner as the limited

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5. A turnkey contract was explained as an agreement which "would normally state a single amount as being the consideration for the performance of drilling to some specific stage, either to the point of setting production casing or, in some instances, through completion to the tanks." ROA Vol. XXIII at 301.

partner's investment in a second-tier partnership involving the same general and limited partners as the first tier partnership. The capital supplied to the second-tier partnership by the COPP loan funds would then be used to obtain working interests and operating agreements from Pioneer in connection with additional oil and gas leases. The limited partners participating in both the first- and second-tier partnerships would have a basis to claim another tax deduction of approximately 90% of its initial investment as expenses and intangible drilling and development costs involved in the development of the lease acquired by the second-tier partnership. Under the Bradford Plan, a limited partner participating in both tiers of the Bradford Partnerships would thus be able to claim deductions equivalent to aobut 180% of his initial investment.[6]

The gravamen of plaintiffs' claims was the assertion that the representations made to the prospective investors were false and misleading in respect both to the availability of bona fide COPP loans from an outside lending institution and the legality of the investments to be used as a tax shelter. Specifically, plaintiffs alleged that material misrepresentations were made by William D. Bradford, John H. Burgher, James L. Houghton, and Grady D. Harris[7] to induce the investors to purchase the Bradford Partnership, and that as a result of their reliance on the misrepresentations they sustained damages. Plaintiffs also alleged

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6. As an example, the District Court illustrated that a limited partner who invested $10,000 in the first-tier partnership and elected to participate in the second-tier, the investor would have a basis to claim a tax deduction on its initial investment in the amount of $18,000 for income tax purposes. *Feldman, supra,* at 918.

7. Grady D. Harris died in August 1974 before this suit was filed. Plaintiffs sued his Estate in this case filed in 1976.

that Fidelity Bank, N.A. and its president Grady D. Harris aided and abetted in a conspiracy to promote the scheme by engaging in a fraudulent and deceptive transaction to create the false appearance to prospective investors that the Bradford Partnerships could and would obtain the COPP loans from Fidelity Bank.

Each of the four "test" plaintiffs deducted 180% of his Bradford investment in the Federal income tax returns. In 1975, the Internal Revenue Service conducted a review of the Bradford Partnerships. It found that the manner in which the second-tier partnerships were structured as a tax shelter was a "sham," and recommended that a disallowance of each of the plaintiffs' deductions on the second-tier of the programs. While the IRS is disputing the view taken by the investors that their deductions on the second-tier investment were legitimate, the record before us discloses that none of the investors, including the "test" plaintiffs have been required to pay any additional taxes with respect to their 1972 Federal income tax returns. Indeed, the IRS has attempted to settle with the investors of the Bradford partnership programs by designating the unresolved tax disputes as "settlement vehicles." This means that each investor can claim a deduction of 100% on the actual amount of his investment. There is evidence in the record which shows that some of the investors have resolved their tax disputes with the IRS on this basis.

The District Court properly set out the elements essential to the establishment of a private cause of action under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78j(b), Rule 10b-5 issued thereunder, 17 C.F.R. Sec. 240.10b-5.[8] A

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8. Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78j(b), provides that "(i)t shall be unlawful for any person, directly or indirectly,

(Cont'd)

plaintiff has the burden of proving every element of his Rule 10b-5 anti-fraud action, including damages. The law on damages generally does not require a plaintiff to establish "the quantum of damages 'with mathematical precision,' " but there must be sufficient evidence introduced by the plaintiff to provide a trier of facts with an intelligent means in determining an appropriate damages award without speculation or conjecture. *King & King Enterprises v. Champlin Petroleum Co.*, 657 F.2d 1147, 1158 (10th Cir. 1981). Although neither Section 10(b) of the Act nor Rule 10b-5 contains explicit provisions for determining damages, courts have applied the "actual damages" standard of Section 28 of of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78bb(a),[9]

(Cont'd)

by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—(b) To use or employ, in connection with the purchase of sale of any security registered on a national exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities and Exchange Commission Rules, 17 C.F.R. Sec. 240.10b-5, provides that "(i)t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

9. Section 28 of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78bb(a) provides in pertinent part that "(t)he rights and remedies provided by this chapter

(Cont'd)

to Rule 10b-5 claims.[10] Under Section 28 of the Act, the "correct measure of damages . . . is the difference between the fair value of all that the (plaintiff) received and the fair value of what he would have received had there been no fraudulent conduct." *Randall v. Loftsgaarden,* 478 U.S. ____, 106 S.Ct. 3143, 3152, 92 L.Ed.2d 525 (1986) (quoting *Affiliated Ute Citizens v. United States,* 406 U.S. 128, 155, 92 S.Ct. 1456, 1473, 31 L.Ed.2d 741 (1972)).

The failure to show actual damages is a fatal defect in a Rule 10b-5 cause of action. *Estate Counseling Service, Inc. v. Merrill*

(Cont'd)

shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."

10. The Supreme Court in *Randall v. Loftsgaarden,* 478 U.S. ____, 106 S.Ct. 3143, 3152, 3155, 92 L.Ed.2d 525 (1986), declined to decide the "issue whether and under what circumstances rescission or a rescissory measure of damages is available" in a Rule 10b-5 action. However, it noted that a lower court in *Blackie v. Barrack,* 574 F.2d 891, 909 (9th Cir. 1975), decided that "it is within the discretion of the district judge in appropriate circumstances to apply a rescissory measure." 106 S.Ct. at 3153. The case law in our Circuit requires that the plaintiff must act promptly in seeking a rescissionary measure of damages as soon as he learned or had reason to put him on notice of the fraud, or he waives his right to rescind. *Estate Counseling Service Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 303 F.2d 527, 532 (10th Cir. 1962). We are not persuaded that the District Court improperly refused to consider the plaintiffs' alternative remedy of rescission upon a finding that plaintiffs waited nearly two years to assert this equitable relief after they had "information sufficiently suggestive of the alleged fraud" by the defendants. *Feldman, supra,* 606 F.Supp. at 923.

Appendix B

Lynch, Pierce, Fenner & Smith, Inc., 303 F.2d 527, 533 (10th Cir. 1962). Upon a careful examination of the record, we agree with the District Court's finding that the record discloses that plaintiffs had ample opportunity, but simply failed to adduce proof on the amount of actual damages, if any, they allegedly sustained in the investment of the Bradford partnership programs as a result of their reliance on the fraudulent conduct by the defendants. *See Feldman, supra,* 606 F.Supp. 916, 924 n. 5.[11] We need not engage in a lengthy discussion on the plaintiffs' contention that the District Court applied the erroneous legal standard in determining damages in this Rule 10b-5 action by following the "tax benefit offset rule" announced in *Austin v. Loftsgaarden, (Austin II)* 768 F.2d 949 (8th Cir. 1985) (en banc), affirming *Austin I,* 675 F.2d 168, 181 (8th Cir. 1982). The *en banc Austin II* decision was subsequently reversed by the Supreme Court in a decision issued approximately two months prior to the oral argument in this appeal. The Court in *Randall v. Loftsgaarden, supra,* held that the measure of damages in an action brought under Section 10(b) of the Securities Exchange Act of 1934 should not be reduced by tax benefits received by a defrauded investor in a tax shelter program. 106 S.Ct. at 3153. Even if the District

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11. The District Court stated that "as early as December 31, 1980 this Court indicated its willingness to consider damages based on the value difference between the investment purchased and the price paid." *See* ROA, Vol. VI at 1723-1725. The District Court, however, found that "no expert testimony was introduced (by plaintiffs) positing such valuation." *Feldman,* 606 F.Supp. at 924 n. 5. Plaintiffs have submitted an attachment to their opening brief, entitled "Compilation of Damages of Various Plaintiffs," which purports to show the amount of damages allegedly sustained by each plaintiff who had resolved his tax dispute with the IRS. Plaintiffs provide no citation of this attachment to the trial record, and we find no reference in the record that the contents of this attachment were properly introduced into evidence during the trial. We deem it inappropriate to consider evidentiary matters which were not presented to and passed upon by the District Court in the first instance.

Appendix B

Court had the benefit of the guidance provided in the *Randall* decision, we believe that an application of the decisional law under *Randall* to the factual finding by the District Court that plaintiffs failed to establish a factual and legal right to relief would not change its ultimate conclusion in granting defendants' Rule 41(b) motion to dismiss plaintiffs' claim asserted under Rule 10b-5 and state common law fraud principles.[12] Our decision in affirming the District Court's order of dismissal upon its finding and conclusion that plaintiffs failed to meet their burden of proving all of the requisite elements of their causes of action also applies to their claims asserted against the defendant, The Estate of Harris. We therefore need not consider the propriety of the District Court's determination that the Oklahoma state law provided that a final probate court order barred the plaintiffs from asserting their claims against The Estate of Harris in this litigation.

Accordingly, the Judgment of the District Court is AFFIRMED.

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12. *Cf.* The District Court also concluded that "the Plaintiffs have failed to prove they have suffered actual loss even though the tax benefits promised in the prospectus may not materialize." *Feldman, supra,* 606 F.Supp. at 924 (footnote omitted).

APPENDIX C — DENIAL OF PETITION FOR REHEARING EN BANC BY THE COURT OF APPEALS

MAY TERM—JULY 7, 1987

Before The Honorable Monroe G. McKay, The Honorable James K. Logan, The Honorable Stephanie K. Seymour, The Honorable John P. Moore, The Honorable Stephen H. Anderson, The Honorable Deanell R. Tacha, The Honorable Bobby R. Baldock, Circuit Judges, and The Honorable Wesley E. Brown, District Judge.*

No. 85-1432

JEROME I. FELDMAN and MARTIN M. POLLACK, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

LEONARD ROVINS, MORRIS J. FELLNER, LEO P. ARNABOLDI, Jr., BARRY M. BROOKSTEIN, JOEL T. COMITEAU, ESTATE OF LEO L. WHITE, LEUMAS KNITTING MILLS, INC., J. & S. INDUSTRIES, JEFF MISHCON, SHERMAN MICHAELSON, ARNOLD Y. ARONOFF, PAUL TODTFIELD, SIDNEY MARTIN, CHARLES MARIS, PETER MARIS, CHARLES BLOOMGARDEN, GERALD BLUMENTHAL, SAMUEL MESSING, SOLOMON LIEBOWITZ, BARRY GARSSON, OSCAR GOLDBERG, ROBERT ZARETZKY, JOSEPH LONGO, JOSEPH SLAVIN, JOSE ARANDIA, E. MARVIN SOKOL, ANTHONY MICALO, RICHARD ADELSON, CARL KLEIN, JOSEPH PRESSLER, FREDERICK RUDMAN, GUSTAV GOMPRECHT, HAROLD F. RUDMAN, ELVA

* Of the United States District Court for the District of Kansas, sitting by designation.

Appendix C

THOMPSON, NEIL WASSNER, RAY CHESSMAN, MICHAEL STERN, STANLEY DERSHOWITZ, HENRY POLLACK, HERMAN E. GOODMAN, JOHN MAHER, LEE MEHLIG, ESTATE OF SHERMAN MICHAELSON, RICHARD KAHN, PATRICIA DONOVAN, ALBERT E. ABRAHAM, SHELDON KRIEGER, LOUIS MEANY, JOHN LaGRUA, DANIEL MATARRASSO, JOHN TELLING, JAY HARBECK, TENISON NEWSOM, WERNER OSTBURG, LEWIS CROWLEY, JAMES MORRILL, EILEEN FORD, ESTELLE KESSLER, HERMAN ROSENBERG, O.J. GLANTZ, ERICH SEGAL, HAL LINDEN, MICHAEL STEWART, JOSEPH CATES, JERRY KATZ, SAUL LAZAROW, ARETHA FRANKLIN, JERRY VALE, ALBERT RETTIG, HERBERT WEINREB, ROONE ARLEDGE, ALEX STOOPLER, ALLAN ABRAMS, JULIAN STOOPLER and FREDERICK SCHWARTZMAN,

Plaintiffs in Intervention,

JOHN H. RILEY,

Applicant for Intervention,

vs.

PIONEER PETROLEUM, INC., FRONTIER CORPORATION, THE ESTATE OF WILLIAM D. BRADFORD, FIDELITY BANK, N.A., and ALICE JUNE HARRIS,

Defendants-Appellees

SECURITIES AND EXCHANGE COMMISSION, NORMAN C. CROSS, JR., and CROSS & COMPANY,

Amici Curiae.

Appendix C

This matter comes on for consideration of appellant's petition for rehearing and suggestion for rehearing en banc in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

The petition for rehearing having been denied by the panel to whom the case was argued and submitted, and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Judge Holloway did not participate in the consideration of this petition.

s/ Robert L. Hoecker
ROBERT L. HOECKER, Clerk

APPENDIX D — STATUTES AND REGULATIONS INVOLVED

Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b)

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> > (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality or interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> > (a) to employ any device, scheme, or artifice to defraud,
> >
> > (b) to make any untrue statement of a material fact or to omit to state a material

fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Securities Exchange Act § 28(a), 15 U.S.C. § 78bb(a)

The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chater shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder. No State law which prohibits or regulates the making or promoting of wagering or gaming contracts, or the operation of "bucket shops" or other similar or related activities, shall invaiidate any put, call, straddle, option, privilege, or other security, or apply to any activity which is incidental or related to the offer, purchase, sale, exercise,

settlement, or closeout of any such instrument, if such instrument is traded pursuant to rules and regulations of a self-regulatory organization that are filed with the Commission pursuant to section 78s(b) of this title.

Securities Exchange Act § 29(b), 15 U.S.C. § 78cc(b)

Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which athe making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided*, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance

upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.